CBO Publication

SUMMARY

August 1995

THE ECONOMIC AND BUDGET OUTLOOK: AN UPDATE

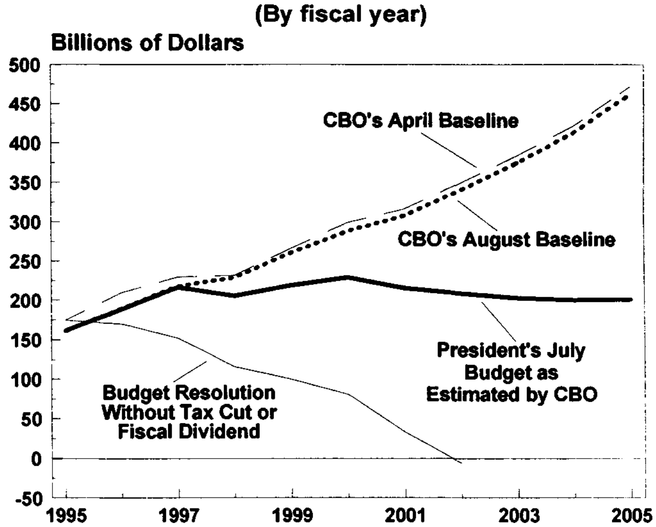
In *The Economic and Budget Outlook: An Update*, the Congressional Budget Office (CBO) projects a lower rate of economic growth and a smaller deficit for the current year than it had anticipated last winter. CBO now estimates that the deficit for fiscal year 1995 will be $161 billion, the lowest since 1989 and the lowest as a percentage of gross domestic product (GDP) since 1979 (see the table on the reverse side). Otherwise, CBO's longer-term economic and budget projections, which assume no change in current laws and policies, are little different from those released earlier this year.

CBO forecasts that real GDP will grow by only 1.3 percent in 1995 (on a fourth-quarter-to-fourth-quarter basis), significantly lower than the 2.5 percent envisioned seven months ago. CBO believes the economy is fundamentally sound, however, and is more likely to grow at a faster rate in 1996 than to slip into a recession. After 1996, CBO projects, the economy will grow in real terms at an average rate of 2.4 percent a year.

CBO's estimated deficit for fiscal year 1995 of $161 billion--which is $13 billion lower than that estimated in April--would mark the third straight year of declining deficits. Deficits will begin rising steadily in 1996, however, if current policies remain unchanged. Assuming that discretionary spending rises at the rate of inflation after 1998 (the year that statutory caps on appropriations expire), CBO projects that the deficit will reach $462 billion (4 percent of GDP) by 2005. Alternatively, if discretionary spending is frozen at the 1998 dollar level once the caps expire, the deficit will grow to $292 billion (2.5 percent of GDP) at the end of 10 years.

Although CBO's projections are based on a continuation of current policies governing federal spending and revenues, both the Congress and the Administration have proposed significant changes to those policies in order to balance the budget (see the figure). Consideration of these proposals will take on increasing urgency as the Treasury approaches the statutory limit on federal borrowing in October or November. The budget resolution passed by the Congress proposes changes in fiscal policies intended to eliminate the deficit by 2002. The President's plan, by contrast, proposes smaller savings each year to balance the budget by 2004. Since CBO's economic and budgetary assumptions are slightly less optimistic than the Administration's, CBO estimates that the President's plan would reduce the deficit to about $200 billion in 2004 rather than eliminate it. The exact economic implications of balancing the budget are difficult to gauge. However, CBO estimates that likely drops in interest rates and increased real growth would further improve the government's fiscal outlook by lowering federal interest payments and raising revenues.

CBO's Comparison of Projected Deficits (By fiscal year)



Questions concerning the budget projections should be directed to CBO's Budget Analysis Division (202-226-2880) and inquiries about the economic forecast to the Macroeconomic Analysis Division (226-2750). The Office of Intergovernmental Relations is CBO's Congressional liaison office and can be reached at 226-2600. For additional copies of the report, please call the Publications Office at 226-2809.

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CBO's Budget Projections and Underlying Assumptions

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Budget Projections (By fiscal year)											
In Billions of Dollars											
Baseline Total Deficit[a]											
With discretionary inflation after 1998	161	189	218	229	261	288	308	340	375	414	462
Without discretionary inflation after 1998	161	189	218	229	243	250	247	256	264	275	292
As a Percentage of GDP											
Baseline Total Deficit[a]											
With discretionary inflation after 1998	2.3	2.6	2.8	2.8	3.1	3.2	3.3	3.5	3.6	3.8	4.0
Without discretionary inflation after 1998	2.3	2.6	2.8	2.8	2.9	2.8	2.6	2.6	2.5	2.5	2.5
Economic Assumptions (By calendar year)											
Nominal GDP (Billions of dollars)	7,058	7,385	7,764	8,165	8,587	9,032	9,497	9,986	10,501	11,042	11,610
Real GDP (Percentage change)	2.6	1.9	2.3	2.4	2.4	2.4	2.4	2.4	2.4	2.4	2.4
CPI-U (Percentage change)[b]	3.1	3.4	3.4	3.3	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Unemployment Rate (Percent)	5.7	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0	6.0
Three-Month Treasury Bill Rate (Percent)	5.4	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1	5.1
Ten-Year Treasury Note Rate (Percent)	6.5	6.4	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7	6.7

SOURCE: Congressional Budget Office.

a. Caps on discretionary spending are set by law through 1998. Measures of the deficit "with discretionary inflation" assume that discretionary spending grows at the rate of inflation after 1998. Measures of the deficit "without discretionary inflation" assume that discretionary spending remains frozen in dollar terms at the level of the 1998 caps.

b. CPI-U is the consumer price index for all urban consumers.